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No. 83-1485

In The

Supreme Court of the United States

October Term, 1983

JOSEPH A. MOLLER and DOROTHY D. MOLLER,
Petitioners,

v.

THE UNITED STATES,
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

PETITIONERS' REPLY TO BRIEF FOR THE UNITED STATES

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Petitioners, Joseph A. and Dorothy D. Moller, respectfully reply to the Brief for the Respondent, the United States, in Opposition to Petitioners' Petition for a Writ of Certiorari.

STATEMENT

Petitioners respectfully submit that Respondent's Statement misstates Petitioners' securities transactions during the years in question by understating the number of Petitioners' sales and ignoring the number of purchases.

In 1976, Petitioners engaged in 41 sales of securities, the total dollar amount of which was $1,679,813 (Pet. App. A-18). In 1977, Petitioners engaged in 30 sales of securities for a dollar volume of $821,028 (Pet. App. A-18).

In 1976, Petitioners engaged in 83 purchases of securities, the value of which was $1,844,669 (Pet. App. A-17, 18). In 1977, Petitioners engaged in 76 purchases of securities which had a value of $958,073 (Pet. App. A-17, 18).

In total, Petitioners conducted 124 securities transactions in 1976 and 106 in 1977, having dollar volumes of $3,534,482 and $1,779,101, respectively, for the two years in question (Pet. App. A-17, 18).

ARGUMENT

Petitioners' Brief in Support of the Petition for a Writ of Certiorari stated that there are conflicts among the Circuits, and confusion and inconsistencies between the ruling of the Court of Appeals below and prior decisions of this Court. Respondent's Brief confirms this confusion.

1. Petitioners' Brief pointed out four different trade or business tests which this Court and the Courts of Appeals have applied, and stated that investors are entitled to know which applies. Respondent maintains all four apply (Resp. 9), while contending that one — the facts and circumstances test of *Higgins v. Commissioner*, 312 U.S. 212, 61 S. Ct. 475, 85 L. Ed. 783 (1941) — is not a test at all (Resp. 12), leaving three tests. Of the remaining three, Respondent maintains that the "trader versus investor" test is but an application of the "goods or services" test (Resp. 10), leaving two tests.

Respondent's Brief thus posits a two-prong trade or business test which requires that a taxpayer (1) offer

goods or services to others, and (2) regularly and extensively engage in investment activity. To begin with, *Higgins* did not mandate or even suggest that Justice Frankfurter's concurring opinion in *Deputy v. Du Pont*, 308 U.S. 488, 60 S. Ct. 363, 84 L. Ed. 416 (1940), which first mentioned a "goods or services" test, was to be considered in determining whether an investor is in a trade or business. *Higgins* was decided by this Court one year after *Du Pont*, and this Court not only failed to use Justice Frankfurter's test, but instead adopted a different test which requires examination of all the facts in each case.

However, assuming for argument's sake only that Respondent is correct in its two-prong test, *Higgins* did not mandate the decision of the Court below, as suggested by Respondent. In *Higgins*, the taxpayer completely failed to satisfy the goods or services requirement because he did not sell securities. Higgins only purchased four lots of tax-exempt bonds in a two-year period. The regularity of his activity of record keeping and dividend and interest collection was irrelevant because he failed to meet half the trade or business test relied on by Respondent.

2. Respondent states that this Court in *Higgins* found the number of transactions and the time devoted to them to be irrelevant. That conclusion does not represent an accurate reading of *Higgins*. The taxpayer's transactional activity in *Higgins* was absolutely minimal, and he made no sales whatever. Thus, how much time he devoted to the passive activities of collecting interest and dividends and keeping records was not an issue.

3. Respondent objects to what it perceives as Petitioners' position that an income-producing activity is a trade or business if engaged in to a sufficient extent. Respondent also suggests that an emphasis on quanti-

tative factors to determine whether an activity is a trade or business merely distinguishes large investors from small ones and could discriminate against small investors.

Respondent misses the point. It is not the dollar amount of the investment that counts but the regular, continuous and extensive nature of the activity which determines whether a trade or business is present. This is precisely the analysis applied elsewhere in the tax law to distinguish between an income-producing activity and a trade or business. The operation of a single piece of rental property may be a trade or business or an income-producing activity, depending on the level of the activity. *Lagreide v. Commissioner*, 23 T.C. 508, 512 (1954); *Robinson v. Commissioner*, 2 T.C. 305, 308 (1943). Conversely, the passive operation of several rental units may be an income-producing activity and not a trade or business. *Scott v. Commissioner*, T.C. Memo. 1979–29. Recently, the Tax Court declared in *Hoopengarner v. Commissioner*, 80 T.C. 538 (1983), that "almost any sec. 212 activity can be transformed into a sec. 162 activity by intensification of the taxpayer's participation in the activity. Thus, every sec. 212 activity is an inchoate sec. 162 activity." 80 T.C. at 543.

4. Respondent's attempt to diminish the distinction between *Higgins* and the present case by stating that the only difference between the two cases is the number of transactions and the time devoted to them is misleading. This is always precisely the difference between a trade or business and an income-producing activity. Petitioners legitimately devoted their full time to their sizeable securities transactions, and thus graduated into a highly successful trade or business.

5. Respondent's assertion that securities are goods in the hands of a trader but not in the hands of an

investor, and that only traders are therefore in a trade or business defies rationality. Both traders and investors sell securities in the same marketplace: the stockmarket. Neither sells to the public, and both are indeed prohibited from doing so. Both traders and investors are market participants who seek a return on their investments. Any distinction between the two based on the risk of their investment is illusory; both are subject to the same changes of the market. Indeed, it has recently been suggested that there is no meaningful distinction between traders and investors in the trade or business context. *See* Orbach and White, *How to Establish the Existence of a Trade or Business in Light of Recent Conflicting Decisions*, 32 Taxation for Accountants 208, 211 (April, 1984).

6. Respondent has completely failed to explain the clear conflict between *Helvering v. Wilmington Trust Co.*, 124 F.2d 156 (3d Cir. 1941), *rev'd on other grounds*, 316 U.S. 164, 62 S. Ct. 984, 86 L. Ed. 1352 (1942), which holds securities transactions are never a trade or business, and those cases holding such transactions are a trade or business in proper circumstances. Respondent's suggestion that *Gajewski v. Commissioner*, 723 F.2d 1062 (2d Cir. 1983), and *Wilmington Trust Co.* can be resolved because, while each is based on different reasoning, each would produce identical results, is simply wrong. *Gajewski* stated that a "professional investor" meets the goods and services requirement and can be in a trade or business in appropriate circumstances. Respondent's assertion that *Gajewski* indicated only traders can meet this requirement is incorrect; the Second Circuit used the term "professional investor" exclusively and did not suggest a distinction between traders and investors. 723 F.2d at 1067, n.8.

Nothing in *Wilmington Trust Co.* suggests that securities transactions can ever constitute a trade or business, or implies that securities are somehow goods only

in the hands of a so-called trader. Indeed, *Wilmington Trust Co.* found that the taxpayer's substantial and frequent speculative stock dealings did not distinguish her from the taxpayer in *Higgins*. 124 F.2d at 160. No clearer conflict is possible than that between *Wilmington Trust Co.* and those cases which hold securities transactions are a trade or business in appropriate circumstances.

CONCLUSION

The conflicts among the Circuits on the issue whether a securities investor can be in a trade or business for purposes of the home office deduction is real. Respondent's Brief has not been successful in finessing it away. The issue is important and recurring. For these reasons, a Writ of Certiorari should issue to review the judgment and opinion of the Court of Appeals for the Federal Circuit.

Respectfully submitted,

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CERTIFICATE OF SERVICE

DAVID R. FRAZER certifies that he is a member of the Bar of this Court and the counsel of record for Petitioners in this cause; that on this _____ day of June, 1984, he mailed three (3) copies of Petitioners' Reply to Brief for the United States in this cause by depositing same in the U.S. mail, first-class postage prepaid, to:

Solicitor General
Department of Justice
Washington, D.C. 20530

that all parties required to be served have been served, in compliance with Supreme Court Rule No. 28.

David R. Frazer